

## **FITCH AFFIRMS DWR CYMRU'S SENIOR SECURED DEBT AT 'A'**

Fitch Ratings-London-22 July 2013: Fitch Ratings has affirmed Dwr Cymru (Financing) Ltd's (Dwr Financing) senior secured rating on its class A debt and class B debt (both wrapped and unwrapped) at 'A' and its class C debt at 'BBB+'. The company has redeemed all its existing class C debt and, therefore, the affirmation of the senior subordinated class C debt of the bond programme at 'BBB+' indicates the level at which Fitch would expect to rate any prospective issuance, if any. The Outlooks on the ratings are Stable.

Dwr Financing is the debt-raising vehicle of Dwr Cymru Cyfyngedig (Dwr Cymru or Welsh Water). Dwr Cymru is one of the ten appointed water and sewerage companies (WaSC) in England and Wales and the sixth-largest by regulated asset value (RAV).

The affirmation reflects Dwr Cymru's sound regulatory and operational performance for the financial year ending March 2013 (FY13) and expectations of incremental improvements over the remainder of the price control ending in March 2015. Other important factors for the ratings are revenue visibility in the UK water sector until March 2015, the not-for-profit nature of the group's business model and the covenanted and secured financing structure, including early warning signals based on financial and non-financial parameters (defined as trigger events in the documentation).

Ofwat, the economic regulator for the UK water sector, will modify the tariff-setting methodology for the price control period from April 2015 to March 2020 to focus more on customer service and sustainability. To date there has been little guidance as to how these changes will be implemented. Therefore, Fitch cannot judge the impact of the upcoming tariff settlement on the credit quality of the sector at this stage. However, we note that as a not-for-profit organisation, Dwr Cymru has no obligations to pay dividends and built up substantial financial flexibility during the current price control period through progressive deleveraging. Therefore, the company is comparatively better placed to face any future challenges than other companies in the sector.

### **KEY RATING DRIVERS**

#### **Substantial Financial Flexibility**

Fitch forecast pension-adjusted net debt/RAV to move towards 60% for the combined class A and class B debt for the period to March 2015. Post-maintenance and post-tax interest cover (PMICR) is expected to range between 1.5x and 1.6x. While gearing provides for increasing headroom in comparison with Fitch's ratio guidelines, the interest cover ranges at levels that are in line with existing ratings.

#### **Improved Regulatory Performance**

For FY13 Welsh Water reported stable asset serviceability for all asset categories, representing good progress in fulfilling its regulatory contract after a marginal assessment of sewerage non-infrastructure the year before. In terms of customer service, the company was ranked number three amongst WaSCs and met its leakage targets. In the area of pollution incidents some reference levels were missed, but capital spending for the remaining two years of the price control still includes schemes that are expected to alleviate some of these minor deficiencies.

#### **Not-for-Profit Organisation**

Dwr Cymru is a not-for profit organisation, which makes it unique among its peers as there is no shareholder pressure to pay dividends, and consequently it can reinvest all its financial surpluses into the business for the benefit of customers.

#### **Targeted Operating and Capital Spending**

After taking day-to-day operations back in house Welsh Water outperformed Ofwat's targets for operating expenditure in the order of GBP48m/8% during the first three years of the price control.

In terms of capital expenditure, the board of directors consciously decided to pursue additional schemes over and above the regulator's baseline. The company has this flexibility as there is no need to pay dividends.

The additional investment at the same time causes incremental operating expenditure to operate the new assets and/or processes. Furthermore, there are some cost pressures related to doubtful debt, the adoption of private sewers, the carbon reduction commitment, movements in power costs and inflation. As a result, Fitch expects Dwr Cymru to slightly overspend in FY14 and FY15.

#### LIQUIDITY

As of 31 March 2013, Dwr Cymru had GBP157m in cash and cash equivalents available as well as GBP215m of undrawn, committed bank facilities against debt falling due over the next two years of GBP91m. This funding position will provide for sufficient liquidity for capital expenditure and operating requirements until March 2015. In accordance with transaction documentation, the group also maintains a GBP135m reserve liquidity facility which would be available in times of financial distress.

#### RATING SENSITIVITIES

Positive: Future developments that could lead to a positive rating action include:

- A sustainable reduction in target gearing to below 60% together with maintenance of current regulatory performance.

Negative: Future developments that could lead to negative rating action include:

- A marked deterioration in operating and regulatory performance or adverse changes to the regulatory framework.
- A sustainable increase in target leverage to above 73% for combined class A and class B debt.

Contact:

Principal Analyst  
Victoria Munarriz  
Analyst  
+44 20 3530 1419

Supervisory Analyst  
Oliver Schuh  
Director  
+44 20 3530 1263  
Fitch Ratings Limited  
30 North Colonnade  
London E14 5GN

Committee Chair  
Arkadiusz Wicik  
Senior Director  
+48 22 338 62 86

Media Relations: Peter Fitzpatrick, London, Tel: +44 20 3530 1103, Email: [peter.fitzpatrick@fitchratings.com](mailto:peter.fitzpatrick@fitchratings.com).

Additional information is available on [www.fitchratings.com](http://www.fitchratings.com). For regulatory purposes in various jurisdictions, the supervisory analyst named above is deemed to be the primary analyst for this issuer; the principal analyst is deemed to be the secondary.

Applicable criteria, 'Corporate Rating Methodology', dated 08 August 2012, are available at [www.fitchratings.com](http://www.fitchratings.com).

Applicable Criteria and Related Research:

Corporate Rating Methodology

[http://www.fitchratings.com/creditdesk/reports/report\\_frame.cfm?rpt\\_id=684460](http://www.fitchratings.com/creditdesk/reports/report_frame.cfm?rpt_id=684460)

ALL FITCH CREDIT RATINGS ARE SUBJECT TO CERTAIN LIMITATIONS AND DISCLAIMERS. PLEASE READ THESE LIMITATIONS AND DISCLAIMERS BY FOLLOWING THIS LINK: [HTTP://FITCHRATINGS.COM/UNDERSTANDINGCREDITRATINGS](http://fitchratings.com/understandingcreditratings). IN ADDITION, RATING DEFINITIONS AND THE TERMS OF USE OF SUCH RATINGS ARE AVAILABLE ON THE AGENCY'S PUBLIC WEBSITE 'WWW.FITCHRATINGS.COM'. PUBLISHED RATINGS, CRITERIA AND METHODOLOGIES ARE AVAILABLE FROM THIS SITE AT ALL TIMES. FITCH'S CODE OF CONDUCT, CONFIDENTIALITY, CONFLICTS OF INTEREST, AFFILIATE FIREWALL, COMPLIANCE AND OTHER RELEVANT POLICIES AND PROCEDURES ARE ALSO AVAILABLE FROM THE 'CODE OF CONDUCT' SECTION OF THIS SITE. FITCH MAY HAVE PROVIDED ANOTHER PERMISSIBLE SERVICE TO THE RATED ENTITY OR ITS RELATED THIRD PARTIES. DETAILS OF THIS SERVICE FOR RATINGS FOR WHICH THE LEAD ANALYST IS BASED IN AN EU-REGISTERED ENTITY CAN BE FOUND ON THE ENTITY SUMMARY PAGE FOR THIS ISSUER ON THE FITCH WEBSITE.